



THE COMMONWEALTH OF MASSACHUSETTS
OFFICE OF THE ATTORNEY GENERAL

ONE ASHBURTON PLACE
BOSTON, MASSACHUSETTS 02108-1598

THOMAS F. REILLY
ATTORNEY GENERAL

(617) 727-2200
<http://www.ago.state.ma.us>

September 6, 2006

Ms. Mary L. Cottrell, Secretary
Department of Telecommunications and Energy
One South Station, 2nd Floor
Boston, Massachusetts 02110

Re: NSTAR Electric, D.T.E. 06-40

Dear Secretary Cottrell:

Enclosed for filing in the above referenced matter is the original and eight (8) copies of the Attorney General's Initial Brief. Thank you.

Sincerely,

/s/

Colleen McConnell
Assistant Attorney General

cc: Service List

COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Boston Edison Company, Cambridge Electric Light Company,)
Canal Electric Company and Commonwealth Electric Company,)
d/b/a NSTAR Electric)

D.T.E. 06-40

CERTIFICATE OF SERVICE

I hereby certify that I have this day caused the foregoing document to be served upon each person on the service list compiled by the Secretary. Dated at Boston this 6th day of September, 2006.

/s/
Colleen McConnell
Assistant Attorney General
Office of the Attorney General
Utilities Division
One Ashburton Place
Boston, MA 02108
(617) 727-2200

COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Boston Edison Company, Cambridge Electric Light Company,)
Canal Electric Company and Commonwealth Electric Company,)
d/b/a NSTAR Electric)

D.T.E. 06-40

**INITIAL BRIEF OF
THE ATTORNEY GENERAL**

Respectfully submitted,

THOMAS F. REILLY
ATTORNEY GENERAL

By: Colleen McConnell
Assistant Attorney General
Utilities Division
Public Protection Bureau
One Ashburton Place
Boston, MA 02108
(617) 727-2200

September 6, 2006

TABLE OF CONTENTS

I.	INTRODUCTION	1
II.	PROCEDURAL HISTORY	1
IV.	THE COMPANY’S PROPOSAL	4
V.	STANDARD OF REVIEW	7
VI.	ARGUMENT	8
A.	THE DEPARTMENT SHOULD NOT RECLASSIFY CAMBRIDGE’S 13.8 kV TRANSMISSION FACILITIES AS DISTRIBUTION FACILITIES UNTIL PLANNED CAPITAL ADDITIONS ARE COMPLETE.	8
1.	The Department Should Decide the Issues of the Transfer of the 13.8kV Facilities in a Separate Proceeding.	8
2.	The 13.8 kV Assets Do Not Meet FERC’s Seven Part Test For Inclusion In Distribution At This Time.	9
3.	The Companies’ Proposal Does Not Comply With Massachusetts General Laws, Department Precedent or the Department Approved Settlement Agreement in D.T.E. 05-85.	12
B.	THE DEPARTMENT SHOULD REJECT THE COMPANIES’ PROPOSAL TO CONSOLIDATE THEIR BASIC SERVICE RATES UNTIL THEY CAN QUANTIFY THE BILL IMPACTS.	14
C.	THE DEPARTMENT SHOULD REJECT THE COMPANIES’ PROPOSAL TO AMORTIZE CERTAIN GENERAL PLANT ACCOUNTS.	16
1.	The Department Should Deny The Companies’ Proposed 15-Year Amortization Of Certain General Plant Accounts.	17
2.	The Department Should Order The Companies To Maintain Detailed Account Information For Its Plant Accounts and Subaccounts.	18
VII.	CONCLUSION	19

Boston Edison Company, Cambridge Electric Light Company,
 Canal Electric Company and Commonwealth Electric Company,
 d/b/a NSTAR Electric

D.T.E. 06-40

On May 26, 2006, pursuant to G.L. c. 164, §96, the Companies filed a Petition with the Department for approval to merge into one company and to change their accounting and rate treatment of certain cost items. On June 29, 2006, the Department conducted a public hearing and a procedural conference to establish a schedule for discovery, hearings and briefs. At the public hearing, the Department granted full intervenor status to the Cape Light Compact (“CLC”), the Energy Consortium (“TEC”), Retail Energy Suppliers Association (“RESA”), Massachusetts Institute of Technology (“MIT”) and Harvard College. The Department granted limited intervenor

status to Northeast Energy Associates Limited Partnership (“NEA”) and Direct Energy Services, LLC (“Direct Energy”).

The Department conducted four days of evidentiary hearings. The Companies presented five witnesses to testify in support of their proposal: Christine L. Vaughan, Manager of Revenue Requirements, Henry LaMontagne, Director of Regulatory Policy and Rates, Amin Jessa, Manager of System Engineering, Timothy Revellese, Manager of Station and Transmission Construction, and John J. Spanos, Vice President of Valuation and Rates Division, Gannett Fleming, Incorporated.

III. OVERVIEW

The Department approved the merger of Boston Edison and Commonwealth Energy Systems in *Boston Edison/Commonwealth Energy Systems Merger*, D.T.E. 99-19 (1999). The Department found that “[t]he evidence demonstrates that the projected merger-related savings will be \$656.9 million over the ten-year period between the years 2000 and 2009, less \$24 million in pre-merger initiatives, for total merger-related savings of \$632.5 million.” *Id.*, p. 73. The Supreme Judicial Court affirmed the Department’s decision. *Attorney General v. Department of Telecommunications and Energy*, 438 Mass. 256 (2002). The Companies now request approval to take the next step in the merger process and merge the corporate entities of Cambridge, Commonwealth and Canal into one corporation, Boston Edison, that will be renamed NSTAR Electric. *See* Exh. NSTAR-CLV-1.

In D.T.E. 05-85, the Department approved a rate settlement (“D.T.E. 05-85 Settlement”). *NSTAR Electric/NSTAR Gas Company*, D.T.E. 05-85 (2005), in which the parties agreed that NSTAR Electric would make a number of regulatory filings before the Department and the Federal Energy Regulatory Commission (“FERC”) to seek approval to complete the merger approved in

D.T.E. 99-19. *Id.* Boston Edison, Cambridge, Commonwealth, and Canal Electric are operated as a single company and its corporate structure should reflect that. The millions of dollars in merger savings the Department identified in D.T.E. 99-19 are reflected in the cost of service and rates approved in D.T.E. 05-85.

The D.T.E. 05-85 Settlement also contains provisions for regulatory filings related to Post-Merger Distribution and Transmission Rates. D.T.E. 05-85 Settlement, Sections 2.17, 2.18. Although there will be one corporate identity, NSTAR Electric shall maintain separate distribution rates and transition rates for the three geographic areas representing the service territories of Boston Edison, Cambridge, and Commonwealth until January 1, 2010. *Id.*, Section 2.16. At that time, NSTAR Electric may apply for rate consolidation subject to Department review and approval. *Id.*

After consummation of the merger, NSTAR Electric may petition FERC, pursuant to Section 205 of the Federal Power Act (“FPA”) (16 U.S.C. § 824d), for a new uniform transmission rate for NSTAR Electric. In addition, the parties agreed that after the consummation of the merger, Cambridge’s 13.8 kilovolt (“kV”) facilities presently classified as transmission facilities for rate recovery (*see Investigation by the Department into the Classification of Transmission and Distribution Facilities*, D.P.U./D.T.E. 97-93 (1998)) shall be reclassified as distribution facilities and the associated costs will be recovered in distribution rates after a separate proceeding. D.T.E. Settlement, Section 2.18.

The Department should approve the merger of Boston Edison, Cambridge, Commonwealth, and Canal Electric into NSTAR Electric. It is in the public interest for the corporate structure to reflect the reality that the company operates as a single integrated transmission and distribution

company. Approval will ensure that the Companies' customers will realize the savings contemplated in D.T.E. 99-19 and reduce the existing corporate complexity by having one set of regulatory books. The Department should, however, reject several aspects of the Petition as premature and inconsistent with the approved D.T.E. 05-85 Settlement.

The Companies' request to classify the 13.8 kV facilities as distribution is premature. Only after mid-2007, when the Companies complete transmission and distribution upgrades, should the Department consider the 13.8 kV system distribution under FERC's seven point test. The settlement also requires "*a separate proceeding*" before the Department "*after the consummation of the merger.*" D.T.E. 05 -85 Settlement, Section 2.18 (emphasis added). The Department should reject the Company's attempt to accelerate the filing process set forth in the settlement agreement. In addition, the proposed depreciation accrual rates for the merger plant accounts are not expense neutral in compliance with the D.T.E. 05-85 Settlement. *Id.*, Section 2.6.2.

IV. THE COMPANY'S PROPOSAL

The Companies' Petition asks for approval to merge Cambridge, Commonwealth and Canal into Boston Edison so that the facilities, properties and other rights, assets, franchises and liabilities will vest in Boston Edison.¹ Exh. NSTAR-CLV-1, p. 4; Exh. NSTAR-CLV-2. According to the Companies, this merger is a completion of the operational merger the Department approved in *Boston Edison/Commonwealth Energy Systems Merger*, D.T.E. 99-19 (1999). *Id.*, p. 7. If approved, the merger will result in the retirement of the common stock of Cambridge and Commonwealth and

¹ On May 26, 2006, NSTAR Electric also filed an Application to Merge for FERC approval under Section 203 of the FPA. *See* FERC Docket No. EC06-126-000.

the conversion of common stock of Cambridge, Canal and Commonwealth into Boston Edison common stock, all of which will then be owned by NSTAR Electric. *Id.* The Companies propose to finance the recall of Cambridge and Commonwealth's debt with Boston Edison's issuance of \$200 million of 30-year debentures in the first quarter of 2006 and amortize the call premiums over the remaining life of the new debt. *Id.*, p. 11.

The Companies propose to consolidate their retail rates for Default ("Basic") Service and the Pension Adjustment Factor ("PAF").² Exh. NSTAR-CLV-1, p. 12. The Companies claim that the consolidation of the retail rates for Basic Service and the Pension Adjustment Factor will have no aggregate affect on the rates residential and small commercial customers pay. The proposed change in the Basic Service rates, however, would result in differences between the blended zone rate³ and individual component rates. *Id.*, p. 13. Similarly, the proposed consolidation of the Companies' PAFs into one NSTAR Electric PAF would result in a decrease in the PAF for Cambridge and Commonwealth customers and an increase for Boston Edison customers. *Id.*, p. 15.

The Companies also propose to consolidate their retail rates for retail Transmission Service. *Id.*, p. 12. The Companies' current transmission costs are recovered through separate FERC-

² The Companies will maintain separate distribution rates and transition charges for customers in the existing service territories of each company until at least January 1, 2010. Exh. NSTAR-CLV-1, p. 9; *see* Settlement Agreement, Section 2.18, *NSTAR Electric Company*, D.T.E. 05-85 (2005).

³ If the merger is approved, NSTAR Electric will operate in two zones, the Northeast Massachusetts load zone ("NEMA") and the Southeast Massachusetts load zone ("SEMA"), just as Boston Edison currently does, and will continue blending the two NEMA and SEMA Basic Service rates as ordered by the Department. Exh. NSTAR-CLV-1, p. 13; *Investigation by the Department of Telecommunications and Energy on its own motion into the Provision of Default Service*, D.T.E. 02-40-A, p. 11 (2003).

approved rates and tariffs that consist of regional and local costs⁴ passed through to retail customers on a load basis. *Id.*, p. 16. If the Companies' Petition is approved, Boston Edison's existing local FERC transmission tariff will be the surviving tariff for the merged companies on file at FERC.⁵ *Id.* According to the Companies, because the existing transmission rates for each of the companies are formula rates with similar provisions, the cost impact of consolidating them will be minimal. *Id.* The Companies anticipate minimal cost shifting if their regional transmission costs, with the exception of congestion management costs,⁶ are consolidated as proposed, since these costs are currently socialized among all the transmission providers on a network load basis. *Id.*, p. 17. The Companies assert that uncertainty about the future amount of congestion costs prevented them from determining the impact congestion management costs will have on consolidating the Companies' transmission costs. *Id.*, p. 18.

Cambridge's transmission tariff currently includes 13.8 kV facilities that the Companies, in

⁴ Regional costs consist of (1) Regional Network Service ("RNS") costs; (2) Scheduling and Dispatch costs; (3) Congestion Management costs; (4) System Restoration and Planning costs; (5) REMVEC local control center costs; (6) Volt-amperes Reactive ("VAR") support; and (7) NEPOOL administration costs. Exh. NSTAR-CLV-1, p. 16. Local costs consist of (1) Local Network Service ("LNS") costs and (2) Local Scheduling and Dispatch costs. Exh. NSTAR-CLV-1, p. 13.

⁵ If the Petition is approved, NSTAR Electric, as the surviving entity, anticipates making a Section 205 filing under the FPA to revise the surviving Boston Edison tariff. Exh. AG-4-6; Tr. 1, pp. 54-55. The Companies propose to adjust the Boston Edison transmission tariff to reflect the consolidation of transmission rates by (1) adopting Boston Edison transmission depreciation rates for assets originally owned by Cambridge and Commonwealth; (2) eliminating inter-company support and expenses and revenues; (3) reclassifying costs among FERC accounts; and (4) adopting an assumed capital structure for the combined companies of 55 percent common equity. Exh. NSTAR-CLV-1, pp. 19-20 (revised).

⁶ The congestion management costs recovered through transmission rates are made up of Reliability Must Run ("RMR") and Special Constrained Resources ("SCR") costs. Exh. NSTAR-CLV-1, p. 17. RMR costs are established by load zone and then socialized within each load zone on a network load basis to all the companies in the load zone. *Id.* SCR costs are charged specifically to the company that requires the SCR for local reliability purposes. *Id.*, p. 18.

their Petition, are proposing to transfer from transmission facilities to distribution facilities in order to recover the costs associated with the 13.8 kV facilities in distribution rates. *Id.*, p. 17. The Companies claim that additions to Cambridge's system, such as a new East Cambridge substation and 115 kV lines, have changed the operating characteristics of the 13.8 kV facilities from an integrated 13.8 kV transmission network to a distribution system that provides power to local load. *Id.* p. 21. The Company proposes to recover the costs associated with the 13.8 kV facilities (including the costs of the East Cambridge substation and 115 kV lines) based on a calculation of the revenue requirement of the facilities using the FERC transmission tariff rate formula, not Department ratemaking precedent. *Id.*, p. 26.

The Companies are also proposing to establish uniform depreciation rates so that the total depreciation expense for Boston Edison, Cambridge and Commonwealth, using the rates currently in effect, will result in the same total depreciation expense under the new combined rates within each functional category, Intangible Plant, Distribution Plant and General Plant. *Id.*, p. 29. The Companies propose to change the accounting treatment for their investment in general plant equipment from depreciation to amortizable property. *Id.*, p. 34.

V. STANDARD OF REVIEW

Pursuant to G.L. c. 164, §96, the Department may review mergers and acquisitions in order to assess their consistency with the public interest. When deciding whether a merger is consistent with the public interest, the Department applies a balancing test of the merger's costs and benefits. *Eastern Colonial Acquisition*, D.T.E. 98-128, p. 5 (1999), citing *Boston Edison Company*, D.P.U. 850, pp. 5-8 (1983). The Department will allow a merger to proceed if the public interest would be

at least as well served by the approval of the merger as by its denial. *Eastern-Essex Acquisition*, D.T.E. 98-27, p. 8 (1998); *Boston Edison/Commonwealth Energy System Merger*, D.T.E. 99-19, p. 10 (1999); see *NIPSCO-Bay State Acquisition*, D.T.E. 98-31 (1998). The Department has also defined the public interest standard as being met if “no net harm” results from the merger. *Eastern-Colonial Acquisition*, D.T.E. 98-128, p. 5; *Eastern-Essex Acquisition*, D.T.E. 98-27, p. 8; *NIPSCO-Bay State Acquisition*, D.T.E. 98-31, pp. 9-10.

The Department may analyze various factors under the public interest standard, including (1) effect on rates; (2) effect on quality of service; (3) resulting net savings; (4) effect on competition; (5) financial integrity of the post-merger entity; (6) fairness of the distribution of resulting benefits between shareholders and ratepayers; (7) societal costs; (8) effect on economic development; and (9) alternatives to the merger or acquisition. *Mergers and Acquisitions*, D.P.U. 93-167-A, pp. 7-9 (1994). The Department’s determination that a merger is in the public interest must rest on a record that quantifies costs and benefits. *Id.*

VI. ARGUMENT

A. THE DEPARTMENT SHOULD NOT RECLASSIFY CAMBRIDGE’S 13.8 kV TRANSMISSION FACILITIES AS DISTRIBUTION FACILITIES UNTIL PLANNED CAPITAL ADDITIONS ARE COMPLETE.

1. The Department Should Decide the Issues of the Transfer of the 13.8kV Facilities in a Separate Proceeding.

The Companies’ proposal to merge their facilities, properties and other rights, assets, franchises and liabilities into one company can still occur without transferring Cambridge’s 13.8 kV facilities. The parties to the D.T.E. 05-85 Settlement did agree that the Companies would need to

reclassify the 13.8 kV facilities as the nature of the facilities changed from transmission to distribution, but the parties also agreed that transfer would be decided in a separate proceeding after the merger. D.T.E. Settlement, Section 2.18.

Even if the Companies did not merge, Cambridge would still need to reclassify the 13.8 kV facilities as distribution once all of the transmission upgrades were complete. FERC has even questioned the justness and reasonableness of including the 13.8 kV facilities in Cambridge's formula transmission rates and has set the issue for hearing in FERC Docket No. ER-05-742-000. *Cambridge Electric Light Company and Commonwealth Electric Company*, 111 FERC ¶ 61, 246, 62,132. The Companies have prematurely asked the Department to decide the issues regarding the transfer of 13.8 kV facilities at a rate that FERC has not yet determined to be just and reasonable as part of their merger proceeding. The Department should reject the Companies' proposal to reclassify the 13.8 kV facilities at this time and decide those issues in a future proceeding.

2. The 13.8 kV Assets Do Not Meet FERC's Seven Part Test For Inclusion In Distribution At This Time.

When unbundling transmission and distribution services, FERC established a seven part test to determine which facilities may be classified as distribution facilities: (1) local distribution facilities are normally in close proximity to retail customers; (2) local distribution facilities are primarily radial in character; (3) power flows into local distribution systems, rarely flowing out; (4) when power enters a local distribution system, it is not reconsigned or transported on to some other market; (5) power entering a local distribution system is consumed in a comparatively restricted geographical area; (6) meters are based at the transmission/local distribution interface to measure

power flows into the local distribution system; and (7) local distribution systems will be of reduced voltage. *Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs, by Public Utilities and Transmitting Utilities*, F.E.R.C. Regulations Preambles ¶ 31, 036, 31, 771 (1996) (“Order 888”). In 1997, Cambridge asserted that it had historically viewed its transmission system as being integrated at the 13.8 kV level because of the distances involved, the load characteristics and the urban character of its service territory. *Investigation by the Department into the Classification of Transmission and Distribution Facilities*, D.P.U./D.T.E. 97-93, p. 9. Cambridge also explained that its transmission system forms many parallel paths from interconnections with other utilities and generators and its treatment of its 13.8 kV and above facilities as transmission had been reflected in its transmission tariffs on file at FERC since 1987. *Id.* The Department accepted Cambridge’s application of FERC’s seven part test classifying the 13.8 kV facilities as transmission. *See Investigation by the Department into the Classification of Transmission and Distribution Facilities*, D.P.U./D.T.E. 97-93 (1998).

The Companies no longer consider the 13.8 kV facilities integral to providing the transmission of power to Cambridge’s local load centers because of various upgrades.⁷ Exh. NSTAR-CLV-1, pp. 21-22. The Companies mistakenly claim that the 13.8 kV facilities now meet FERC’s seven part test for classification as distribution facilities, *Id.*, p. 22; Exh. AG-5-9, since

⁷ When Cambridge applied FERC’s seven part test to its transmission facilities in 1997, the 13.8 kV facilities did not meet five of the seven criteria because they (1) were not in close proximity to retail customers; (2) were not radial in character; (3) had power flowing in and out; (4) transported power to other markets; (5) did not send power to be consumed in the area; (6) did have meters based at the interface; and (7) had low voltage levels. Exh. AG-5-9; Exh. DTE-2-10.

modifications to Cambridge's 13.8 kV transmission facilities that would change the character of the system from transmission to distribution are not yet in service. Tr. 1, p. 37; Exh. DTE-5-13; Exh. AG-5-4. The installation of the East Cambridge substation and related 115 kV lines, one of the impetuses for the Companies' proposal to transfer these facilities from transmission to distribution, may not be completed until as late as the first half of 2007.⁸ Exh. DTE-5-13; Tr. 3, p. 408.

The Companies' proposal is premature. Although FERC's seven part test does not include any precise requirements or a bright line test for the Department to use in determining the appropriate classification, the record evidence shows that critical events have not occurred that would support the reclassification of the 13.8 kV facilities. Tr. 1, pp. 37, 56-57; Exh. DTE-5-13; Exh. AG-5-4. The Companies' proposal to transfer the not yet completed facilities as distribution facilities includes incorporating the related costs in Cambridge's distribution rates. The Department has a longstanding precedent of setting rates based on prudently incurred, historic costs adjusted for specific known and measurable changes and a rate base that includes only assets that are used and useful. *Dedham Water Company*, D.P.U. 84-32, p.17 (1984); *Fitchburg Gas and Electric Light Company*, D.T.E. 98-51, p. 12 (1998); *Boston Gas Company*, D.P.U. 93-60, p. 24 (1993). The Companies do not know the full cost of the 13.8 kV projects and those costs are not measurable at this time. Exh. NSTAR-CLV-1, p. 26; Exh. AG-2-14. Until the East Cambridge substation and the related 115 kV lines are in service and operating reliably, the Department should reject the

⁸ The East Cambridge substation was originally scheduled to be in service by the fall of 2005. Exh. AG-1. The Companies have not accurately estimated completion dates in other major projects such as Boston Edison's 345 kV transmission line (phase 1 was scheduled to be in service in July 2006 and now will not be in service until the "end of the summer," Tr. 1, p. 62) and Cambridge's second 115 kV transmission line (delayed for a year because of obstructions and now scheduled to go into service by the end of 2006, Tr. 1, p. 61, 121).

Companies' proposed reclassification.

3. The Companies' Proposal Does Not Comply With Massachusetts General Laws, Department Precedent or the Department Approved Settlement Agreement in D.T.E. 05-85.

The Companies' proposed transfer of Cambridge's 13.8 kV facilities' revenue requirement from Cambridge's transmission tariff to its distribution tariff will result in an increase in distribution rates. The Companies have not provided the Department or their customers the specific rate schedule or tariff that they are proposing to charge customers. The Companies claim that the rate will not be known until later when the actual 2006 costs are available. Exh. NSTAR-CLV-1, p. 26; Exh. AG-2-14. Pursuant to G.L. c. 164, §94, an electric distribution company is required to file with the Department new rates and, after having provided public notice of the change in rates, the Department may suspend the effective date of proposed rates and open an investigation into the propriety of the proposed rates. The Department should reject the Companies' proposal because it does not comply with the statutory requirements.

The Companies' proposal also does not comply with the Department approved Settlement Agreement in D.T.E. 05-85. The D.T.E. 05-85 Settlement allows the Companies to reclassify the 13.8 kV facilities as distribution facilities and recover the associated costs in distribution rates only "*after the consummation of the merger*" and "*after a separate proceeding.*" D.T.E. 05-85 Settlement Agreement, Section 2.18 (emphasis added). The current Petition is a not "separate proceeding," even though the Companies may characterize it that way. *See* Tr. 3, p. 412. Instead, the Petition

inappropriately combines merger issues with those of the 13.8 kV facilities transfer.⁹ The parties to the D.T.E. 05-85 Settlement envisioned that the Department would decide the issue of the reclassification in the context of a G.L. c. 164, § 94, rate case. D.T.E. 05-85 Settlement, Section 2.18. The Department should decide only the merger issues in this proceeding and decide the issues of transferring the 13.8 kV facilities in a future, separate proceeding as envisioned by the Settling Parties and approved by the Department. *Id.*; *NSTAR Electric/NSTAR Gas Company*, D.T.E. 05-85, p. 33.

The Companies' proposal to charge customers the FERC formula transmission rate based on 2006 costs also does not conform to Department ratesetting precedent. The Department is responsible for determining that rates charged customers are just and reasonable. Customers and other parties rely on the application of Department precedent when rates are set. *See Boston Gas Company v. Department of Public Utilities*, 367 Mass 92, 104 (1975). When determining the appropriate functional classification of Cambridge's 13.8 kV facilities, the Department must address how the Companies will recover the costs associated with the 13.8 kV facilities in rates. If the Department applies FERC's revenue requirement, as the Companies propose, it must explain why it has abandoned its traditional ratemaking precedent. *Id.*

Traditionally, the Department has set rates based on a revenue requirement calculation that uses actual costs incurred during a historic test year. *Dedham Water Company*, D.P.U. 84-32, p.17. Certain specific costs may be adjusted for known and measurable changes. *Id.* The return

⁹ Because the Companies do not know the amount of costs associated with the 13.8 kV facilities (Exh. NSTAR-CLV-1, p. 26; Exh. AG-2-14), it is premature for the Department to allow those costs to be recovered in distribution rates without a full investigation.

component of the rates is based on historic year end net plant that has been deemed used and useful. *Fitchburg Gas and Electric*, D.T.E. 98-51, p. 12; *Boston Gas*, D.P.U. 93-60, p. 24. The Companies' proposal asks the Department to abandon its precedent and adopt a revenue requirement that will be the product of a proposed FERC formula rate.¹⁰ FERC formula rates allow current recovery of costs by using a forecasted revenue requirement adjusted for actual costs in a later period. Exh. AG-4-1. In addition to using a forecast of costs, FERC precedent treats a number of cost categories differently than Department precedent, including the treatment of certain pension and benefits costs, prepayments and income tax related items. *Id.* FERC rate formulas currently allow the return on rate base to be computed using the Companies' actual capital structure and a return on equity that is significantly different than those components adopted in the Companies' most recently settled base distribution rate case. Tr. 3, pp. 397-399 and 406-407. Because of these fundamental ratemaking differences, if the Department reclassifies the 13.8 kV facilities as distribution facilities, it should evaluate the transfer of associated costs using its own ratemaking precedent.

B. THE DEPARTMENT SHOULD REJECT THE COMPANIES' PROPOSAL TO CONSOLIDATE THEIR BASIC SERVICE RATES UNTIL THEY CAN QUANTIFY THE BILL IMPACTS.

The Companies propose to consolidate their retail Basic Service rates into one rate for the surviving company, NSTAR Electric. Currently, the Companies each procure their Basic Service supply based on rate class and load-zone. Exh. NSTAR-CLV-1, p. 13. Because Cambridge's

¹⁰ Cambridge and Commonwealth are in settlement proceedings at FERC related to the transmission tariff that the Companies propose will serve as the basis for the "revenue neutral" transfer of cost recovery when the 13.8 kV system is determined to be part of the Cambridge distribution system. Exh. NSTAR-CLV-1, p. 26.

service territory is located entirely in the NEMA load zone, Cambridge currently charges its residential and small commercial customers the NEMA rate. *Id.* Similarly, because Commonwealth's service territory is located entirely in the SEMA load zone, it currently charges its residential and small commercial customers the SEMA rate. *Id.* Boston Edison's service territory, however, is located predominately in the NEMA load zone and partially in the SEMA load zone and Boston Edison currently charges residential and small commercial customers a rate that blends the NEMA and SEMA rates. *Id.*; *Default Service*, D.T.E. 02-40-A, p. 11. According to the Companies' proposed rate consolidation, NSTAR Electric will charge all residential and small commercial customers throughout the merged service territory a blended NEMA and SEMA rate. Exh. NSTAR-CLV-1, p. 13. Although the Companies claim that, in the aggregate, these customers' rates will not change under the proposed rate consolidation (*Id.*), they have not provided the actual bill impacts for Cambridge and Commonwealth residential and small commercial customers based on all of NSTAR Electric's customers receiving the blended rate.¹¹

The Basic Service rates also are affected by the delay in the 345 kV line because import constraints in NEMA prevent lower cost SEMA power from entering the NEMA zone. *Id.*, p.14. This creates a price differential between the zones. Tr. 1, p. 93. Under the proposed rate consolidation, the residential and small commercial customers in Commonwealth's service territory, currently receiving the lower SEMA rate, will most likely experience an increase in their Basic

¹¹ The Companies will not know the Basic Service rates until they know the results of later supply solicitations. Exh. DTE-1-14.

Service rates when they start receiving the blended rates.¹² The completion of Boston Edison's 345 kV transmission line should mitigate this price differential because this new line will increase the transmission capacity to the NEMA zone, reducing transmission congestion constraints. Exh. NSTAR-CLV-1, p. 14.

Department precedent requires it to address rate continuity issues when rates change. *Boston Gas Company*, D.P.U. 96-50-A, p. 4 (1996); see *New England Telephone and Telegraph Company*, D.P.U. 89-300 (1990). Once the 345 kV transmission line is in service and the price differential between NEMA and SEMA has been reduced, residential and small commercial customers may benefit from one consolidated Basic Service rate. The Department should order the Companies to wait until the 345 kV line is in service and they can provide actual bill impacts that demonstrate rate continuity principles have not been violated before consolidating their Basic Service rates.

C. THE DEPARTMENT SHOULD REJECT THE COMPANIES' PROPOSAL TO AMORTIZE CERTAIN GENERAL PLANT ACCOUNTS.

The Companies propose to merge their financial books and regulatory books of account and combine their plant accounts and book depreciation expense based on new accrual rates. Exh. NSTAR-CLV-1, pp. 33-34. The Companies claim the new depreciation accrual rate will be expense neutral in order to comply with the D.T.E. 05-85 Settlement provisions approved by the Department. If the Department approves the Companies' proposed merger, it should (1) deny the Companies'

¹² Also, according to the Companies' own estimates, NEMA customers, including Boston Edison's and Cambridge's, may pay between \$30 to \$80 million more to fulfill reserve requirements in the ISO-NE's Locational Forward Reserve Market costs because the 345 kV line is not in service. Exh. AG-2.

request to amortize certain general plant accounts over 15 years to ensure that the proposed depreciation rates are truly expense neutral; and (2) order the Companies to accrue depreciation expense to accumulated depreciation on an account by account basis.

1. The Department Should Deny The Companies' Proposed 15-Year Amortization Of Certain General Plant Accounts.

The Companies propose to change the method of accounting for certain general plant balances from depreciating to amortizing those accounts over a 15-year period.¹³ Exh. NSTAR-CLV-1, p. 35. The Companies claim this change will be more efficient because the assets are numerous and constitute a small percentage of total plant investment. *Id.*, p. 34. The proposed depreciation accrual rates for the merger plant accounts should be expense neutral in order for the Companies to comply with the D.T.E. 05-85 Settlement. D.T.E. 05-85 Settlement Agreement, Section 2.6.2. The Companies' proposed change, however, does not provide for expense neutral depreciation rates as required by the settlement.

Under NSTAR Electric's current depreciation rates, for example, it would recover approximately \$3.5 million per year in depreciation expense using the June 30, 2005 balances of plant, representing a 7.5 percent annual accrual rate. Tr. 4, p. 545.¹⁴ NSTAR Electric's change to

¹³ The change to amortizing the balances will eliminate the need for the Company to specifically track each asset's specific service life, salvage value, and cost of removal. NSTAR-CLV-1, p. 35. Instead, once the asset is placed in service, its original cost will simply be amortized, on a straightline basis, over a fixed number of years with no specific recognition of the retirement of the asset. *Id.*

¹⁴ Bench examination:

But I had determined that the total plant balance in Accounts 391 through 398, excluding the computers, came to about \$46,659,000. And using the new, proposed depreciation rates, I came up with an annual accrual of just under 3 1/2 million without the computers. And that suggested to me a composite depreciation rate of about 7 1/2 percent... Tr. 4, p. 545.

a fifteen year amortization of these same general plant accounts would actually lower the expense since it would represent a change to a 6.67 percent annual accrual rate [$1 / 15 = 0.067$ (rounded)]. The Companies' proposal does not comply with the Department approved D.T.E. 05-85 Settlement since the Companies would under accrue depreciation by the difference between the two rates, 0.83 percent [$7.5 - 6.67 = 0.83$], each and every year of the settlement period, until those rates were set again in some future rate case. *See* D.T.E. 05-85 Settlement Agreement.

In addition, the D.T.E. 05-85 Settlement only provides for merged depreciation rates, not a change in methodology from depreciation to amortization of plant account balances as the Companies propose. *Id.*, Section 2.6.2. Since the Companies' proposal does not comply with the D.T.E. 05-85 Settlement, the Department should reject the Companies' proposed change to amortize those general plant accounts over a 15-year period.

2. The Department Should Order The Companies To Maintain Detailed Account Information For Its Plant Accounts and Subaccounts.

If the Department approves the Companies' proposed merger of the plant accounts, the Department should order the surviving company, NSTAR Electric, to establish a detailed and accurate accounting of the plant assets. If the merger is approved and NSTAR Electric maintains its plant installation, retirement, cost of removal, salvage value, depreciation expense, and accumulated depreciation data at the plant account / subaccount level going forward, it will be able to provide the best, most accurate information on these accounts, allowing both NSTAR Electric and its regulators, in future analyses, to reduce uncertainty when studying the characteristics of the various types of plant. Therefore, the Department should require NSTAR Electric to maintain its

plant installation, retirement, cost of removal, salvage value, depreciation expense, and accumulated depreciation data at the plant account /subaccount level.

VII. CONCLUSION

For these reasons, the Department should approve the Companies' proposed merger but reject the Companies' proposal to reclassify the 13.8 kV facilities as distribution, consolidate the Basic Service rates, and amortize certain general plant accounts.

Respectfully submitted,

THOMAS F. REILLY
ATTORNEY GENERAL

By: _____
Colleen McConnell
Assistant Attorney General
Utilities Division
Public Protection Bureau
One Ashburton Place
Boston, MA 02108
(617) 727-2200

Dated: September 6, 2006